


STANDARD CLASSIFICATION OF EXPENSE

THE NATIONAL PAPER TRADE ASSOCIATION
OF THE UNITED STATES



ADOPTED NOVEMBER 11th, 1920



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Report of the Cost Accounting Committee



The present Cost Accounting Committee was appointed shortly before the last annual meeting in April. It is composed of Mr. T. K. Cree, of Alling & Cory Company, Pittsburgh; Mr. N. A. Schoenbucker of D. L. Ward Company, Philadelphia; and Mr. W. B. Stevenson of A. Storrs & Bement Company, Boston, Chairman. Colonel B. A. Franklin of the Strathmore Paper Company, Mittineague, who had had much professional experience along the line of cost accounting prior to his entry into the paper industry, as well as since as a member of the Paper Manufacturer's Cost Accounting Committee, when the matter of cost accounting was discussed with him by one of the members of your Board of Directors, offered to assist the Committee in an advisory capacity, and we were very glad to avail ourselves of Colonel Franklin's experience.

Regarding the Committee, would say that Mr. Cree, as auditor of the Alling & Cory Company, has had a great deal of experience in operating a cost accounting system. Mr. Schoenbucker, Treasurer of the D. L. Ward Company, had had considerable experience in cost work in the expert accounting profession prior to his association with the D. L. Ward Company. The writer was appointed to the Committee because of his familiarity with the merchandising problems of the paper trade. Thus we were fortunate in having a well balanced committee.

After a very careful consideration of the matter, it was obvious that whatever system was submitted must be one that could be operated with the least possible disturbance to the present routine accounting in the houses of the various members, and also one requiring the minimum amount of work to give the essential knowledge.

The basic costs to be ascertained were warehouse, direct shipment and indirect shipment. The total expense of doing business includes all three of these factors.

The Committee discussed at length the advisability of following the plan of some cost systems which start with the invoiced unit cost, and then

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load this with the burden of expense incurred during transit through the various processes involved in filling an order. In following such a procedure, overhead is naturally assessed on a basis of price per pound or some similar unit, but we found the units in a paper warehouse differed so in character that it would be impracticable to follow such a plan. For instance, it developed that some paper warehouses handled not only the various kinds of paper, but ice cream cones, butter dishes, clothes lines, matches, hammocks, automobile tires, etc. For this reason, and also because the majority of houses kept no record of sales and purchases on a tonnage basis, it was found impracticable to operate the system in its initial stages on a price per pound basis.

Therefore the only easy, workable method was to operate on a percentage of sales, and the system was devised along this line.

Of course every merchant keeps a record of his total expense, and it is evident that by properly dividing the general expense and allocating to each of the three classes of shipments the proportionate amount which each should bear, he can ascertain these separate classes of expense. We found that already a great many members of the Association are making an analysis of their expense. Therefore to achieve the desired results is simply a matter of having standard classifications for these various items of expense. The principle of the plan was thus conceived, and the method of subdividing and assigning the expense was determined.

Then the question arose as to whether or not the system as developed could be adapted to the methods of bookkeeping in the different houses. We found its operation perfectly feasible in the three houses represented on the Committee, although their systems of bookkeeping are quite different. However, to make sure that the plan could be adopted generally in a majority of the houses, we consulted Ernst & Ernst, an auditing concern of national reputation and large experience, particularly in the paper trade. To determine the adaptability of our system, they offered to make a survey of several wholesale paper establishments. To insure covering all the problems that might be encountered due to local conditions, we selected for this survey merchants situated in a wide area of territory. The result is given in their report, which follows in this booklet.

It has often been said that competition regulates selling prices, regardless of cost, but we believe it is now generally conceded that this is a ruinous plan to follow, and no doubt when intelligent merchants know the cost of handling certain classes of business, they will base their quotations on the known cost, and thus get an adequate return on the sale and also insure fair competition.

Then again, this knowledge is absolutely essential to deal fairly with customers from whom orders have been taken to be billed at price current on date of shipment. During the few years just passed many conscientious merchants were perplexed as to just what percentage above cost they should charge on such orders to insure an adequate profit and still make an equitable price to customer. Probably in most instances the price made

was accepted in any event, because the customer had to have the goods at almost any price. However, if we necessarily follow the plan of price current on date of shipment on a rising market, it is only fair and probable that we shall follow the same plan when it comes to a declining market. On such a market customers will probably not be quite so willing to accept open prices without debate, and we ought to have accurate knowledge of costs on which to base our prices.

Another reason why it is essential that we all adopt a standard cost system, which should be developed to a point where we ascertain the cost of handling various classes of merchandise out of the warehouse, even though we do not carry it to the end of ascertaining the cost of different lines, is clearly exemplified in the cases where the manufacturer recommends the resale price. This practice has become quite prevalent in the last few years, and is becoming of greater importance to all merchants.

During a period such as we have just enjoyed, where the supply is inadequate to the demand, the manufacturer is quite apt to accept the merchant's idea of what constitutes a proper margin of profit on a line where the resale price is suggested by the manufacturer. When it comes to a period where the supply exceeds the demand, however, there is apt to be considerable difference of opinion on this point, and again we should have accurate knowledge on which to base our opinion.

Several manufacturers of high grade papers have, as you know, contended that, owing to the greater price per pound, the merchant should be willing to accept a smaller percentage margin of gross profit, because it costs no more to handle physically a case of high grade, loft-dried paper than a case of low grade, machine-dried paper, but unquestionably the activity of the line, which means the volume of tonnage handled, has considerable bearing on this, and any foresighted man can see that we must necessarily have this information in order to be fair to all concerned.

If it is true that high priced papers can be handled on a smaller percentage of profit, we shall all gladly welcome this fact or any other information which tends to equalize the demand for the different grades, and thus stabilize the industry.

The next question which arises is how are we going to have the plan put into operation, when many houses will need more than the information given in the primer.

The Committee, after considering this point, have arranged to hold sectional meetings of the auditors and accountants of the various houses, at which the system will be explained in detail and standard forms for operation could be submitted to those who desired to inspect them with a view to their adoption to facilitate the operation of the system. Also any ambiguous points that might naturally arise, could be explained.

We have arranged with Ernst & Ernst, who have offices in twenty-two cities, to have a representative give the requisite information at these meetings, if so desired.

Such sectional meetings could be further supplemented by local meetings in each city, held by the men who are directly in charge of the operation of the system. With such cooperation, the necessary amount of information and enthusiasm could be promoted to insure the success and general adoption of the system.

Ernst & Ernst are at the service of any member of the Association to install the system, if desired, and the cost may be ascertained from them. They feel, however, that any extended work on their part will be unnecessary, and that after two or three days' guidance any well organized accounting department should be able to operate the system with comparatively little added labor.

Nothing of any value is to be obtained without some expenditure of effort, time and money, and although the expenditure required to operate this system is negligible compared with the results, the members must make up their minds to the fact that they will have to do some additional work. We believe, however, that every wide-awake merchant will see that the results are going to be of such great benefit to the industry that when the practicability of the system is proven, he will be quite willing to adopt it immediately.

We realize, however, that in order to have this plan adopted, it is necessary that it have the indorsement of the accountants of the various houses. The Committee is confident that these gentlemen can be convinced that the system is fundamentally sound. It will give the capable accountant an opportunity to produce facts that are essential to the executives for the most efficient conduct of the business.

We thought we had a rather new idea for a cost system, but found that this plan, for some time past, has been used in other industries with entire satisfaction.

Your Committee does not consider that its work has been finished, and, if desired, will be glad to continue as a clearing house to try to solve questions which may arise, or to draw further standard forms, if needed to expedite the installation or expansion of the system. Colonel Franklin has also very kindly offered his further assistance along this line.

A great deal of thought and time, and money of the houses represented by their membership, have been spent by your Committee for the good of this Association, and we would respectfully say that we feel it is incumbent upon every member to cooperate by the adoption of this system, which will result in scientific merchandising to the advantage of all concerned.

Respectfully submitted,

COST ACCOUNTING COMMITTEE
NATIONAL PAPER TRADE ASSOCIATION,

W. B. Stevenson, Chairman.

NEW YORK
27 CEDAR ST
PHILADELPHIA
LAND TITLE BLDG
BOSTON
MERCHANTS NATL BK BLDG
WASHINGTON
MUNSEY BLDG
ATLANTA
CHAMBER OF COMMERCE BLDG
BUFFALO
PRUDENTIAL BLDG
PITTSBURGH
221 FOURTH AVE.
CLEVELAND
SCHOFIELD BLDG
CINCINNATI
UNION TRUST BLDG
INDIANAPOLIS
LEMCKE ANNEX
PROVIDENCE
HOSPITAL TRUST BLDG

ERNST & ERNST

AUDITS AND SYSTEMS

NEW YORK

October 1, 1920

CHICAGO
CONTL & COM L BK BLDG
ST. PAUL
MERCHANTS BANK BLDG
MINNEAPOLIS
FIRST NATL-500 LANE BLDG
DETROIT
DIME BANK BLDG
TOLEDO
SECOND NATL BANK BLDG
ST. LOUIS
BOATMEN'S BK BLDG
KANSAS CITY
NEW YORK LIFE BLDG
DALLAS
AMERICAN EXCHANGE BK BLDG
FT. WORTH
BURTON BLDG
HOUSTON
UNION NATL BANK BLDG
NEW ORLEANS
HIBERNIA BANK BLDG

THE COST COMMITTEE OF THE NATIONAL PAPER TRADE ASSOCIATION OF THE UNITED STATES

NEW YORK CITY.

Gentlemen:

We submit herein for your consideration, our recommendations for a "Standard Classification of Expense" for The National Paper Trade Association of the United States.

The information on which these recommendations are based was obtained in a survey made by our organization in twelve Wholesale Paper Establishments located in the following cities:

New York	Indianapolis
Philadelphia	St. Louis
Boston	Cincinnati
Chicago	Cleveland
Minneapolis	Pittsburgh

We found that all Wholesale Paper Merchants were confronted with practically the same problems, that physical conditions and details varied to some extent, but from an accounting standpoint the same principles would apply and could be easily adapted to meet any condition existing.

Our efforts were devoted solely to the preparation of a Standard Classification of Expense that may be adopted by the members of the Association.

The prime purpose of this accounting is to provide a method for determining the expense applicable to and the cost of, doing business in

connection with the three general divisions of sales, represented in the following:

- (1) Warehouse Shipments
- (2) Indirect Shipments
(Deliveries made direct from railroad car or ship to customer in merchant's city.)
- (3) Direct Shipments
(From mill direct to customer)

It is very important to keep in mind however, that while this particular effort has been directed towards establishing a Standard Classification of Expense and an equitable distribution of it to the three general classes of sales; the ultimate object to be attained is, to make it possible for merchants to allocate expense to departments or lines of merchandise and determine the profit and loss derived from the sales of each.

The proposed Classification of Expense is flexible and it can with some slight modifications, be adapted to meet the requirements of any Wholesale Paper Establishment. The number of Expense Accounts that a merchant may desire to use under any general classification is optional with him. He may eliminate and consolidate, or he can use additional accounts provided that the principle is generally observed.

There is no feature introduced in our recommendations that should add any clerical labor in any office that is now conducting its accounting with the ordinary double entry methods.

There is ample opportunity for some divergence of opinion upon the application of certain expenses to sales and to lines of merchandise but excessive indulgence in argument on technicalities involving comparatively small expenditures will only tend to defeat the ends that can be attained through uniformity and standardization.

Too fine a classification of expense and the clerical effort attendant upon such an effort will discourage practical merchants while on the other hand something more general and equitable would suffice and have a stronger appeal and at the same time serve as a basis for higher and further development when the time is opportune.

Our System Staff Managers who conducted the surveys in their respective cities have expressed their appreciation for the courtesies and practical assistance extended to them by the organizations in the establishments that it has been our privilege to survey.

Very truly yours,

[Signed] ERNST & ERNST.

[SEAL]

Exhibit "A"

Standard Classification of Expense

In arriving at our conclusions upon which to base our recommendations, we prepared a composite Chart of Expense accounts that represented all of the accounts used by the twelve establishments.

From this composite Chart we have developed the "Standard Classification of Expense" shown on opposite page and identified as Exhibit "A".

This exhibit is designed for the purpose of making it an easy matter to visualize quickly the plan recommended for a Standard Classification of Expense for Wholesale Paper Merchants.

The Expenses are first classified into five general groups representing the main activities of the business as follows:

- Warehouse
- Delivery
- Selling
- Administrative
- General Office

Under each of these general groups, we have listed the names or titles of accounts that may be used for the purpose of analyzing the various expense elements that enter into the cost of conducting each activity.

At the bottom of the exhibit and under each group, we have indicated the class of shipments that the expense group applies to and the basis upon which the expense is apportioned to the sales, represented in the following shipments:

- (1) Warehouse Shipments
- (2) Indirect Shipments
- (3) Direct Shipments

Exhibit "A"

Standard Classification of Expense

THE NATIONAL PAPER TRADE ASSOCIATION OF THE UNITED STATES

Prepared by ERNST & ERNST, New York

Warehouse Expense	Delivery Expense	Selling Expense	Administrative Expense	General Office Expense
Cost of Space Depreciation Insurance Light, Heat and Power Rent Repairs to Buildings Sundry Expense Taxes on Real Estate Wages—Janitors, etc.	Cost of Automobile Operation Depreciation Gasoline, Oil and Grease Insurance Rent—Garage Repairs and Parts Sundry Expense Taxes Tires and Tubes Wages	Cost of Advertising Catalogs, Folders, etc. Depreciation Postage—Mailing Rent Samples Salaries Services of Agency Space in Publications Stationery and Supplies Sundry Expense	Associations and Conventions Donations Legal and Professional Rent Salaries—Executive Sundry Expense Taxes (Except Federal Income Tax) Traveling—Executive	Depreciation Collections, Credit & Exchange Insurance Postage Rent Repairs—Office Equipment Salaries—Office Stationery, Printing & Supplies Sundry Expense Taxes Telephone and Telegraph
Cost of Handling Insurance—Liability Insurance—Stock Packing Material and Supplies Sundry Expense Wages—Receiving and Storing	Cost of Team Operation Depreciation Hay, Straw, Feed Horseshoeing Insurance Rent—Stable Repairs Sundry Expense Veterinary Wages	Cost of Direct Selling Commissions Depreciation Postage Rent Salaries—Inside Salesmen Salaries—Outside Salesmen Salaries—Mgr., Ass'ts. and Steno's. Stationery and Supplies Sundry Expense Telephone and Telegraph Traveling—Mgr. & Ass'ts. Traveling—Executive		
Warehouse Expense Applies only to Warehouse Shipments	Delivery Expense Applies to Warehouse Shipments and Indirect Shipments "A" distributed on the basis of the time that Autos and Teams are engaged on each or "B" charge indirect shipments on basis of "ton rates" charged by Public Truckmen, the balance of expense applies to Warehouse Shipments.	Selling Expense Applies to Warehouse Shipments and Indirect Shipments and Direct Shipments Distributed on the Basis of Sales	Administrative Expense Applies to Warehouse Shipments and Indirect Shipments and Direct Shipments Distributed on the Basis of Sales	General Office Expense Applies to Warehouse Shipments and Indirect Shipments and Direct Shipments Distributed on the Basis of the Number of Orders Handled

Exhibit "B"

A monthly or periodical Statement of Expense Distribution such as shown by Exhibit "B" on opposite page is available to any merchant upon adoption of the Standard Classification of Expense and without the necessity of costing sales.

This statement serves its purpose in that it indicates the Percentage of Expense to Net Sales but it is not a statement of Profit and Loss.

The money values shown on this exhibit are all assumed figures, but nevertheless it will serve to illustrate the practical application of the expense accounts shown on Exhibit "A".

It is a comparatively easy matter involving only a small amount of clerical labor to classify the Sales according to Warehouse, Indirect and Direct Shipments which information is the basis for the allocation of Warehouse Selling and Administrative Expenses.

Exhibit "B"

Typical Statement of Expense Distribution

	Warehouse Shipments	Indirect Shipments	Direct Shipments	Total
Sales				
Gross.....	\$60,000.00	\$5,000.00	\$15,000.00	\$80,000.00
LESS: Returns.....	1,000.00	-0-	1,500.00	2,500.00
NET SALES.....	\$59,000.00	\$5,000.00	\$13,500.00	\$77,500.00
Per Cent To Total	76.13%	6.45%	17.42%	100%
Expenses				
Warehouse.....	3,000.00			3,000.00
Basis—All to Warehouse				
Delivery				
Basis—Time in Use.....				1,100.00
82% Warehouse Shipments	902.00			
18% Indirect Shipments..		198.00		
100%				
Selling				
Basis—Sales.....				6,500.00
76.13% Warehouse Shipments	4,948.45			
6.45% Indirect Shipments..		419.25		
17.42% Direct Shipments...			1,132.30	
100%				
Administrative				
Basis—Sales.....				2,500.00
76.13% Warehouse Shipments	1,903.25			
6.45% Indirect Shipments..		161.25		
17.42% Direct Shipments...			435.50	
100%				
General Office				
Basis—Number of Orders..				1,800.00
3,000 Orders—Warehouse Shipments	1,764.68			
10 " Indirect "		5.88		
50 " Direct "			29.44	
3,060 Orders—Cost \$58.823 per 100 orders				
Total Operating Expense..	\$12,518.38	\$784.38	\$1,597.24	\$14,900.00
Per Cent To Net Sales	21.218%	15.688%	11.831%	19.226%

Exhibit "C"

A monthly statement of Profit and Loss such as shown by Exhibit "C" on opposite page is available to merchants who adopt the practise of Costing Sales and who classify them according to the three classes of shipments.

The expense applied is in the same amounts as shown on Exhibit "B".

Exhibit "C"

Typical Statement of Profit and Loss

Month of January, 1920

	Warehouse Shipments	Indirect Shipments	Direct Shipments	Total
Sales				
Gross.....	\$60,000.00	\$5,000.00	\$15,000.00	\$80,000.00
LESS: Returns.....	1,000.00	-0-	1,500.00	2,500.00
NET SALES.....	\$59,000.00	\$5,000.00	\$13,500.00	\$77,500.00
Cost of Sales.....	44,250.00	4,000.00	11,475.00	59,725.00
GROSS PROFIT...	14,750.00	1,000.00	2,025.00	17,775.00
Per cent. of Gross Profit to Net Sales	25%	20%	15%	22.935%
Expenses				
Warehouse.....	3,000.00	-0-	-0-	3,000.00
Delivery.....	902.00	198.00	-0-	1,100.00
Selling.....	4,948.45	419.25	1,132.30	6,500.00
Administrative.....	1,903.25	161.25	435.50	2,500.00
General Office.....	1,764.68	5.88	29.44	1,800.00
TOTAL EXPENSE	\$12,518.38	\$784.38	\$1,597.24	\$14,900.00
Per cent. of Expense to Net Sales	21.218%	15.688%	11.831%	19.226%
NET PROFIT IN MERCHANDISING	2,231.62	215.62	427.76	2,875.00
Per cent. of Net Profit to Net Sales	3.782%	4.312%	3.169%	3.709%
Other Income				
Interest on Bank Balances....				88.00
Discount on Purchases.....				201.00
				289.00
		TOTAL		3,164.00
Other Deductions				
Interest on Borrowed Money				275.00
Discount Allowed Customers				220.00
Loss on Bad Accounts.....				100.00
		TOTAL		595.00
ADDITION TO PROFIT AND LOSS—SURPLUS				\$2,569.00

Exhibit "D"

Exhibit "D" represents a statement of the operations of the business as a whole. Other exhibits showing the results according to the three classes of sales would, of course, be made on the same plan and these would be subsidiary to any supporting Exhibit "D".

While the combined statement of the business as a whole is of prime importance for first information it is necessary, however, to prepare monthly comparative schedules showing the results of operations according to the three classes of sales, in order to be in a position to determine the real sources of profit and loss and determine how fluctuations in total sales effect the general net profit result.

To illustrate, let us assume the total sales remain constant. If, on the other hand, Warehouse Shipments decrease \$50,000.00 per month and Direct Shipments increase \$50,000.00, it will naturally follow that Warehouse Expense must be curtailed to conform to reduced Warehouse business. The comparative expense percentages will indicate more readily than anything else, whether the business is operating on an economical basis or otherwise.

Exhibit "D"

Comparative Statement of Profit and Loss

	Period Ending			Total for Three Months
	January	February	March	
Sales				
Gross.....	\$80,000.00	\$100,000.00	\$120,000.00	\$300,000.00
LESS: Returns.....	2,500.00	2,700.00	2,900.00	8,100.00
NET SALES.....	\$77,500.00	\$97,300.00	\$117,100.00	\$291,900.00
Cost of Sales.....	59,725.00	73,743.67	92,239.67	225,708.34
GROSS PROFIT...	17,775.00	23,556.33	24,860.33	66,191.66
Per cent. of Gross Profit To Net Sales	22.94%	24.21%	21.23%	22.68%
Expenses				
Warehouse.....	3,000.00	3,045.00	3,090.00	9,135.00
Delivery.....	1,100.00	1,116.50	1,133.00	3,349.50
Selling.....	6,500.00	6,597.50	6,695.00	19,792.50
Administrative.....	2,500.00	2,537.50	2,575.00	7,612.50
General Office.....	1,800.00	1,827.00	1,854.00	5,481.00
TOTAL EXPENSES	14,900.00	15,123.50	15,347.00	45,370.50
Per cent. of Expenses To Net Sales	19.23%	15.54%	13.11%	15.54%
NET PROFIT IN MERCHANDISING	2,875.00	8,432.83	9,513.33	20,821.16
Per cent. Net Profit To Net Sales	3.71%	8.67%	8.12%	7.14%
Other Income				
Interest on Bank Balances....	88.00	100.00	120.00	308.00
Discount on Purchases.....	201.00	220.00	240.00	661.00
	289.00	320.00	360.00	969.00
TOTAL.....	3,164.00	8,752.83	9,873.33	21,790.16
Other Deductions				
Interest on Borrowed Money...	275.00	300.00	325.00	900.00
Discount Allowed Customers..	220.00	230.00	240.00	690.00
Loss on Bad Accounts.....	100.00	110.00	120.00	330.00
TOTAL.....	595.00	640.00	685.00	1,920.00
ADDITION TO PROFIT AND LOSS-SURPLUS	\$2,569.00	\$8,112.83	\$9,188.33	\$19,870.16

Exhibit "E"

Balance Sheet, January 31st, 1920

ASSETS			
Current			
Cash			
On Hand.....	\$1,000.00		
On Deposit.....	29,000.00	\$30,000.00	
Accounts Receivable			
Customers—City.....	\$115,000.00		
Customers—Country.....	105,000.00		
Sundry Accounts.....	8,000.00	228,000.00	
LESS: Allowance for Doubtful	6,999.00	222,000.00	
NOTES RECEIVABLE.....	32,000.00		
Notes Receivable Discounted	6,000.00	26,000.00	
Merchandise Inventories			
On Hand.....	82,000.00		
In Transit.....	10,000.00	92,000.00	
TOTAL CURRENT ASSETS			\$370,000.00
Other Assets			
Investments.....		14,000.00	
Loans to Employees.....		30,000.00	44,000.00
Permanent Assets			
Real Estate.....	14,000.00		
Buildings.....	120,000.00		
Machinery and Equipment.....	13,200.00		
Motor Truck Equipment.....	8,800.00		
Teams and Wagons.....	4,400.00		
Furniture and Fixtures.....	2,200.00	162,600.00	
LESS: Allowance for Depreciation....	16,260.00	146,340.00	
Deferred Assets			
Prepaid Advertising.....	2,000.00		
Prepaid Insurance.....	1,500.00		
Prepaid Interest.....	500.50	4,000.50	
			\$564,340.50

This Exhibit is shown for the purpose of illustrating the method of arranging Asset and Liability accounts of the business in accordance with modern practice. The accounts used are representative as shown by our survey reports.

Exhibit "E"

Balance Sheet, January 31st, 1920

LIABILITIES

Current

Accounts Payable

For Merchandise.....	\$145,000.00	
Sundry Accounts.....	5,000.00	\$150,000.00

Notes Payable

For Borrowed Money.....	15,000.00	
For Merchandise.....	5,000.00	20,000.00

Acceptances Payable

For Merchandise.....		15,000.00
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Accrued Accounts

Accrued Salaries and Wages.....	7,000.00	
Accrued Commissions.....	9,000.00	
Accrued Interest.....	1,000.00	
Accrued Taxes.....	780.00	17,780.00

TOTAL CURRENT LIABILITIES **\$202,780.00**

Reserves

For Federal Taxes.....	2,000.00	
For Contingencies.....	2,725.00	4,725.00

Capital Stock

Preferred Stock-Authorized.....	100,000.00		
LESS: Preferred Stock Unissued.....	50,000.00	50,000.00	
Common Stock-Authorized.....	100,000.00		
LESS: Common Stock Unissued.....	50,000.00	50,000.00	100,000.00

Profit and Loss—Surplus

254,266.50

Profit and Loss—Current Month of January

2,569.00 256,835.50

\$564,340.50

This Exhibit is shown for the purpose of illustrating the method of arranging Asset and Liability accounts of the business in accordance with modern practice. The accounts used are representative as shown by our survey reports.

Warehouse Expense

Accounts

The accounts recommended for use under this classification appear upon Exhibit "A".

We have classified separately the "Cost of Space" and the "Cost of Handling," in order that these two distinct elements of the cost of warehousing may be known and applied by the merchant to the lines of merchandise carried in warehouse stock.

Basis for Distribution to Sales

Warehouse Expense applies only to Sales shipped from Warehouse.

Distribution to Departments or Lines of Merchandise

In every one of the establishments surveyed we devoted particular attention to the solution of the problems involved in the allocation of Warehouse Expense to departments and to lines of merchandise. This subject is of great interest to all merchants and it is also the next logical step to be taken by the Association along the lines of progressive cost accounting.

Some merchants are in favor of distributing the total Warehouse Expense to departments or lines of paper on the basis of "weight," and others on the basis of "Sales Value."

Based on the data obtained during the progress of our surveys, we have concluded that neither "weight" or "Sales Value" can be considered as the controlling factor influencing Warehouse Expense as a whole.

The "weight" basis would penalize coarse papers to the benefit of fine papers; and the "Sales Value" gives no consideration to the cost of space used which is a large factor in the expense of warehousing.

Two factors enter prominently into the Cost of Warehousing and for this reason we have classified the expense accordingly, i.e.

- (1) Cost of Space Used (Rent, etc.)
- (2) Cost of Handling (Receiving, Storing, Shipping)

To those merchants who contemplate a distribution of warehouse

expense to departments or lines of merchandise, we recommend the basis outlined in the following:

Cost of Space Used

Apportioned*on the floor space occupied by departments or lines of merchandise.

Cost of Handling

Apportioned on the Sales where weight cannot be obtained.

Notes on Cost of Handling

The Cost of Handling which includes such expenses as are incidental to the receiving, storing, cutting and shipping operations is influenced by the weight and bulk of merchandise sold. It, therefore, necessarily follows that those lines in which there is a quick turn-over should carry more of this expense than lines that have a slow turn-over.

For the purpose of illustration, let us use two extremes, the "Book Paper Department" and the "Cover Paper Department" and assume further that the stocks of each occupy the same floor space in the Warehouse.

The annual charge to each department for "Space Used" would be the same, this is a definite charge based on a sound principle and, therefore, can be disposed of quite easily.

If it is conceded that the Cost of Handling is influenced by weight of paper handled, then the major portion of the cost of handling would be apportioned to the Book Paper department on account of the more rapid turn-over in Book stock compared with the slower turn-over in Cover stock.

Turn-over may be indicated by weight and in the absence of information as to the weight handled then the Sales value of shipments should be used.

Several of the establishments surveyed devoted a large amount of space and had frequent turn-over in such lines as, envelopes, papetries, corrugated papers, drinking cups, twine, etc. In considering these lines of merchandise with other fine and coarse paper stocks we were inclined to the opinion that the use of "weight" as the basis would penalize some lines to the advantage of other lines and all out of proportion to the inequities that may result from the "Sales" basis.

Paper Cutting Machines are necessary in connection with every warehouse and are usually considered as a part of the equipment incidental to the filling of customers' orders and, therefore, the cost of operating them can, in the usual case, be considered as a part of the "handling expense" of the warehouse.

Delivery Expense

Accounts

The Expense Accounts recommended for use under this classification appear upon Exhibit "A".

It should be noted that we have classified separately the Cost of Operating Autos from the Cost of Operating Teams. We recommend this procedure where both Autos and Teams are used in order to obtain information pertaining to the relative cost of operating each kind of equipment.

Basis for Distribution

Delivery Expense may be applied by one of two methods as follows:

1st Method:

Distribution on the basis of the time that Autos and Teams are engaged on Warehouse Deliveries and Indirect Shipments.

2nd Method:

Charge Indirect Shipments on the "per ton" basis charged by public truckmen and the balance of the expense apply to Warehouse Shipments.

Where all deliveries are made by public truckmen the allocation of this expense becomes a very simple matter as the truckmen can be requested to present their charges classified according to Warehouse Deliveries and Indirect Deliveries.

It is, of course, obvious that no portion of the Delivery Expense applies to Direct Shipments.

Selling Expense

Accounts

The Expense Accounts recommended for use under this classification appear upon Exhibit "A".

It should be noted that we have classified separately the Advertising Expenses from the Direct Selling Expenses, this is done for statistical purposes only and has no bearing on the manner in which these two sub-classifications of Selling Expense are applied to Sales.

The merchant may further sub-divide the Direct Selling Expense into "Inside" and "Outside," and also, "Country" and "City," or in any other manner that suits his purpose.

Basis for Distribution

Selling Expense should be distributed, on the basis of the Sales, to Warehouse, Indirect and Direct Shipments.

Reasons

Advertising and Selling effort is directed primarily to securing a maximum volume of sales.

It usually follows that a more intensive effort is directed to the securing of maximum sales in the lines of merchandise that show the more substantial margins of profit.

More sales effort is naturally expended on an individual sale of \$1,000.00 than on an individual sale of \$10.00, although it is maintained in some quarters that it costs no more to make a large sale than a small sale.

The objective in any selling campaign is always dollars of sales, and not quantity of orders, and the budget appropriation for advertising and Direct Selling Expenses is fixed on a basis predicated on the value of the sales that can be anticipated from the effort.

Note

In several of the establishments surveyed the merchants allocated Selling Expense directly to the two general lines of paper sold. In such cases a part of the selling organization of the merchant's establishment devoted their efforts solely to "Fine" papers and another part to "Coarse" papers.

Administrative Expense

Accounts

The expense accounts recommended for use under this classification appear on Exhibit "A".

Basis for Distribution

This expense should be distributed on the basis of Sales to Warehouse, Indirect and Direct Shipments.

Reasons

Administrative Expense is that expense necessary to the general conduct of a business. In the wholesale paper business and all other business this expense is usually regulated by and is consistent with the size of the business, which in turn is indicated by the volume of business done or sales made.

Administrative Expense since it applies to the business as a whole and on account of its general nature is not confined to any particular activity. It is the general supervision or general management expense of the business.

Variations

In cases where the merchant conducts a manufacturing plant for the manufacture of envelopes, papetries and ruled paper, he may if he prefers make a charge to such departments for Administrative Expense and include it as a part of the departments manufacturing overhead. This, however, is not essential as the product sold from such departments would ultimately receive its charge when actually sold.

There may be some objection to the inclusion of Administrative Expense in manufacturing overhead on the part of some merchants on account of their policy to eliminate the administrative expense from any consideration in their inventory values at the end of a fiscal period.

Note

We found a few cases where the Administrative Expense was arbitrarily apportioned to the Warehouse, Delivery, Selling and General Office.

General Office Expense

Accounts

The Expense Accounts recommended for use under this classification appear on Exhibit "A".

Basis for Distribution

This expense should be distributed on the basis of orders handled for Warehouse, Indirect and Direct shipments.

An order is understood to represent an individual shipment.

Where an original order is in part back ordered or shipped in installments each shipment is considered as an individual order for this purpose.

Reasons

General Office Expense is that expense necessary in connection with the clerical routine of handling customers orders, billing, charging, credits, collecting, filing, inventory records, etc.

The amount of this expense is influenced almost entirely by the number of orders filled or sales invoices issued.

Note

The easiest method for obtaining the information for this distribution is from a count made of the invoices issued in connection with Warehouse, Indirect and Direct Shipments.

Income and Expense Not Considered As Factors in Merchandising Cost

Interest on Investment

Interest on investment in Inventories, Accounts Receivable or Other Trading Assets is not an element of cost and should not be so considered. Profit is the compensation for money and efforts invested in business. The prevailing interest rate for money cannot be considered as a basis or a portion of the reward for effort devoted to business.

Discount Taken in Payment of Merchandise

Discount taken or received is not considered as a reduction of the cost of merchandise or as an income from operations.

It is an earning on Capital and should be so considered, and therefore it becomes an addition made after the Net Profit in Merchandising is determined and is shown on Exhibit "C" classified with other items under "Other Income."

Interest on Borrowed Money

Interest on borrowed money is not considered as an element of cost in conducting a merchandising business.

It is the cost of procuring capital for the conduct of a business and should be so considered, and therefore it becomes a deduction after Net Profit in Merchandising is determined and is shown on Exhibit "C" classified with other items under "Other Deductions."

Discount Allowed

Discount allowed to customers should not be considered as an expense or as a deduction from sales, and therefore is shown on Exhibit "C" as a deduction after Net Profit in Merchandising and classified with other items under "Other Deductions."

Rent

Among the establishments surveyed, we found several that owned all of the real estate and buildings in which they conducted their business. In such cases it seemed to be the general rule, with only one exception, to consider only taxes, insurance, depreciation and repairs, as the equivalent of rent, without any consideration to the inclusion of any interest charge to represent a return on the investment in property owned and used in connection with the business.

It is our opinion that where the merchant is the owner, he should charge against his operations an amount that would be the equivalent of what he would ordinarily have to pay as a rental for like accommodations.

The basis for computing the charge for rent should be made uniform throughout the trade. As a medium from which to negotiate for the determination of a basis to use, we suggest the pre-war custom of fixing the rental charge on a basis of 10% of the reproductive value of the property occupied, this charge to cover insurance, taxes, repairs and depreciation, and a fair return on the investment.

Under this plan and in the case of a property valued at \$300,000.00, an annual rental of \$30,000.00 would be charged against the operations of the business, and a corresponding credit made to "Rental Income" account.

Charges to the rental income would be made for insurance, taxes, repairs and depreciation, and therefore where the merchant owner adopts this principle it will be unnecessary to consider these expenses as specific charges under the classification of Warehouse Expense.

It is desirable to apply the cost of rent to all departments using space, and therefore the rent expense should be apportioned to the following departments:

Warehouse
Delivery
Selling
Administrative
General Office
Manufacturing Departments

Manufacturing Departments

A number of the establishments surveyed conducted Manufacturing Operations for producing envelopes, papetries and ruled paper and among them we found several cases where no particular effort was devoted to determining the exact cost of the product manufactured, and as a con-

sequence manufacturing expenses were included as part of the cost of merchandising and the cost of manufactured product was therefore undervalued.

In those establishments where such products are manufactured, it will be necessary to provide accounts for the purpose of segregating the expense incidental to the operation of such departments from the strictly merchandising activities.

The expense in connection with operating any of the manufacturing departments may be classified as follows:

- (1) Salaries and Wages
- (2) Rent (Space Used)
- (3) Supplies
- (4) Depreciation of Equipment
- (5) Repairs to Equipment
- (6) Sundry Expense

In the application of expense to product in the Envelope and Ruled Paper Departments, the machine hour rate basis is best adapted to the conditions and requirements.

In the Papetries department the man hour rate is usually best adapted to the conditions and requirements.

Prices and Pricing

Definitions of the Term "Price"

"Cost Price" is the actual purchase invoice cost, plus transportation.

"Market Price" is the cost at which the merchandise can be obtained today, sometimes referred to as the "replacement price".

Pricing the Inventory

In the valuation of inventories at the close of a fiscal period "Cost" or "Market" prices, should be used whichever is the lower.

Using the lower price is, of course, the most conservative policy and it also conforms to Federal Income Tax Regulations.

Pricing to Determine Salesmen's Commissions

In pricing the cost of merchandise sold for the purpose of determining the gross profit derived from the Sales made by Salesmen, "market prices" or "replacement values" should be used.

Pricing to Determine Actual Gross Profits

In the determination of actual gross profits for the purpose of the monthly Net Income Statement, the "Cost Prices" only should be used.

Card Cutting

Several of the establishments surveyed maintained small Card Cutting Departments that devoted their efforts solely to cutting cards for stock and for special orders of customers.

The expense of conducting such a department is not a proper charge to Cost of Handling Stock of the Warehouse. Under ordinary circumstances and where only two or three employees are engaged in this labor, we would not recommend an attempt to allocate this expense to any particular kind or size of card, as this would involve keeping record of time spent on each lot or order, and the results derived from this accounting would develop but little information of practical value.

The cost of Card Cutting should be applied as a percentage upon the merchandise cost of cards cut, and on all cards alike regardless of style or size.

In cases where card cutting is a large factor, involving five or more people and where long runs are frequent, we would suggest accounting for the cost against each lot or style of card.

Running Inventory of Stock

Every establishment surveyed maintained a running inventory of stock in quantity only, no prices or values appearing upon the record.

In several of the establishments visited this feature of the accounting was susceptible to considerable improvement on account of lack of proper equipment and organization for carrying on the work.

It is highly essential to the successful operation of a Running Inventory System that competent clerks familiar with the merchandise be assigned to the work, and that records and filing equipment be of the most efficient order.

It is our opinion that 5x8 index cards, filed in open top desks, or on visible index stands is the most serviceable equipment for the purpose.

Monthly Statement of Profit and Loss

Several of the establishments surveyed pursued the practice of costing their sales at replacement values, two establishments used actual cost, and others made no attempt whatever to cost their sales.

It usually followed where replacement values were used in costing sales, that the salesmen were paid a commission or bonus based on a percentage of the gross profit; in such cases this is the only logical procedure to observe.

Where salesmen are not paid on a commission based on a percentage of the gross profit on their sales, then the more correct method is to use

actual cost prices, as, only by this method can the actual profit and loss on merchandising be determined from month to month.

Where a merchant desires to obtain a monthly Statement of Profit and Loss, it is necessary to cost all sales at actual cost prices.

Only two of the establishments that we surveyed had the facilities and pursued the practice of obtaining a monthly Statement of Profit and Loss that reflected actual results from operations. It is our opinion that the additional clerical labor involved in procuring the monthly statements is more than compensated for by the information and analyses that such statements afford the management of these establishments.

An analysis of the cost of sales and sales from month to month, and an equitable application of Warehouse Expense according to the principal lines of merchandise, affords information in regard to turn-over, the relation of inventory to sales and gross and net profits, all of which information should contribute materially to the success of the executive in the control of his merchandising activities.

Based on the information procured during the course of this survey we are convinced that many merchants have only a very vague idea of the turn-over and net profits derived on their principal lines of merchandise.

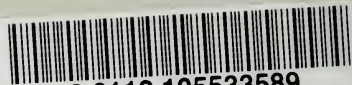
This survey was not initiated for the purpose of arriving at a method for procuring monthly Statements of Profit and Loss, but rather to determine upon a basis for allocating the expense of doing business to the respective sales represented in Warehouse, Direct and Indirect Shipments, and therefore the procuring of a monthly Statement of Profit and Loss or the further distribution of Warehouse Expense to the various lines of merchandise is not necessary to the adoption of a Standard Classification of Expense.

System and Method

We have not attempted to prepare and submit any forms or records for use in connection with a uniform Accounting or Cost System, as we recognize that varying conditions and individual requirements are such that in some cases they would be confusing and in most cases could not be applied in a practical manner.

As indicating the impracticability of recommending forms for standardized system of records to be adopted by all merchants, we cite the fact that in the course of our surveys we made note of five different systems for handling Accounts Payable, every one of which met with every requirement of the merchant; Accounts Receivable ledgers were maintained under three distinct plans, the methods of recording Cash Receipts and Cash Disbursements varied to a wide extent in different establishments.

The methods best adapted to the conditions existing and the particular requirements of the merchant, is in our opinion a matter that concerns the merchant individually and has little or no relation to the adoption by him of any Standardized Classification of Expense that may be recommended by the National Paper Trade Association of the United States.



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